

Under Illinois law, "true leases" and "leases" that are actually conditional sales contracts are treated differently for Retailers' Occupation and Use Tax purposes. See 86 Ill. Adm. Code 130.2010. (This is a GIL).

February 28, 2002

Dear Xxxxx:

This letter is in response to your letters dated November 27, 2001 and January 16, 2002. The nature of your letters and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be accessed at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letters, you have stated and made inquiry as follows:

My company is a Telecommunication Service provider. We are located in STATE and are beginning a start up operation in Illinois. We set up two companies. One will be a regulated utility company offering local and long distance telephone service. It also will lease access to our PBX switch (dial tone to outside lines) in the form of regulated basic service. The other company will be our service company and will lease equipment such as telephones and voice mail systems. It will lease access to our PBX switch (dial tone to inside lines). We will also bill for labor and materials when we install cabling and wiring, add or move phones etc. and management reports (phone call detail).

In speaking with the Illinois tax help-line staff I came to the conclusion that I am not required to file sales tax returns if my income is solely from leasing equipment, provided I paid Use Tax when I purchased the equipment. I am also of the opinion that I am required to file Sales Tax returns only if I sell tangible personal property.

Please confirm my conclusions via return mail. If you need additional information I can be reached.

Thank you in advance for your assistance.

This response is limited to an explanation of your Retailers' Occupation and Use Tax liability. Under separate cover, we are sending you an explanation of your liability under the Telecommunications Excise Tax Act.

For general informational purposes we enclose 86 Ill. Adm. Code 130.2010, the Department's regulation that covers the taxation of leases. Under Illinois law, "true leases" and "leases" that are actually conditional sales contracts are treated differently for Retailers' Occupation and Use Tax purposes. Lessors of tangible personal property, such as phones or other telecommunications equipment, are subjected to a Use Tax on their cost price of tangible personal property that they use by leasing in Illinois. This means lessors encounter a front-end tax on value rather than an amortized tax on receipts. The only exception is automobiles rented for one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

True leases generally have no buy out provisions at the close of the leases. If buy out provisions do exist, they must be fair market value buy out options in order to maintain the character of the true leases. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See, 86 Ill. Adm. Code 130.220(a). As end users of tangible personal property located in Illinois, lessors incur Use Tax liability on their cost price of such property. Except for short-term automobile rentals, there is no tax due upon rental receipts in Illinois.

Under Illinois law, lessors may not "pass through" their Use Tax obligation to lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

Under Section 130.2010(a), persons who purport to "lease" the use of property, but in fact sell such tangible personal property to nominal "lessees," are considered to be making conditional sales subject to Retailers' Occupation Tax. Such would be the case when the agreements contain nominal purchase options at the end of the lease term. In these situations Retailers' Occupation Tax is due on all the payments received by the "lessors."

The retail sale of tangible personal property, such as telecommunications equipment, is generally subject to Retailers' Occupation Tax liability in Illinois. See 86 Ill. Adm. Code 130.101. However, if cable, wiring and equipment is sold and installed so that it is permanently affixed to real estate, a construction contractor situation would exist for the transaction. This is because persons who take tangible personal property and permanently affix it to real estate act as construction contractors. See 86 Ill. Adm. Code 130.1940 and 130.2075. Construction contractors incur Use Tax liability, payable to their suppliers, based upon their cost price of items that they purchase for subsequent incorporation into real estate. If contractors' suppliers are not registered to collect Illinois tax, contractors must pay the tax directly to the Department.

When contractors make sales of items that remain tangible personal property when installed (i.e., are not permanently attached to real estate), they act as retailers and must be registered under Section 2a of the Retailers' Occupation Tax Act (35 ILCS 120/2a) and collect and remit Retailers' Occupation Tax on such transactions. Please see Section 130.1940(b). Charges for installation services on such sales are also subject to tax unless such installation charges are separately contracted for according to 86 Ill. Adm. Code 130.450.

Please be informed that Section 1 of the Retailers' Occupation Tax Act (35 ILCS 120/1) provides that construction contracts for the improvement of real estate consisting of engineering, installation, and maintenance of voice, data, video, security, and all telecommunications systems, do not constitute engaging in a business of selling tangible personal property at retail within the meaning of the Act if they are sold at one specified contract price. Rather, such contractors incur tax liability on their cost price of such systems.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Karl W. Betz  
Associate Counsel

KWB:msk  
Enc.